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C O N F I D E N T I A L SECTION 01 OF 04 BRASILIA 002628

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FOR THE DEPUTY SECRETARY

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SUBJECT: SCENESETTER CABLE FOR VISIT OF THE DEPUTY SECRETARY

Classified By: CDA PHILLIP CHICOLA, REASONS 1.4 (b) AND (d)

11. (SBU) The United States Mission in Brazil warmly welcomes your planned October 5 to 7 visit to Brasilia. Ambassador Danilovich will meet you upon arrival the evening of October 15. The next day, we have scheduled meetings for you with Foreign Minister Amorim, Finance Minister Palocci, Presidential International Affairs Advisor Marco Aurelio Garcia, and Senate leaders. We have also scheduled you to announce the 2006 selections for the Mission's Youth Ambassador's program, to meet with the press and to informally meet and greet Embassy direct-hire personnel. The meeting request with President Lula is still pending.

12. (SBU) Your visit comes in the wake of a series of meetings in Washington between Brazilian cabinet ministers and their USG counterparts the week of September 25. Foreign Minister Amorim met with Secretary Rice, USTR Portman, and yourself. Trade Minister Furlan, in town for the annual Brazil-U.S. Business Council meeting, met with Secretary Gutierrez, USTR Portman, and Secretary Bodman. Finance Minister Palocci, in Washington to attend the Bank/Fund meetings, met with Secretary Snow. And Environment Minister Silva attended a

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bilateral meeting on environmental issues.

#### THE BILATERAL RELATIONSHIP

13. (C) While relations between the U.S. and Brazil are friendly, often the USG encounters major difficulties in gaining the cooperation of senior policymakers on issues of significant interest to the United States. Eager to assert its own influence, the Brazilian government shies away from cooperation with the USG - unless it can clearly be characterized as a reciprocal exchange among equals. Indeed, hyper-sensitivity on issues viewed as infringing on Brazil's sovereignty can get out of hand and may be seen as signs of political immaturity. Many Brazilians believe the U.S. has designs on the Amazon. Our fingerprinting of visitors to the U.S. drew reciprocal treatment for Americans here; visa and immigration issues remain sensitive points.

14. (C) During recent months, our ongoing dialogue with the Brazilians has focused on a variety of potentially useful projects for both sides. We sought to interest the GOB in a Defense Cooperation Accord, but the Foreign Ministry rejected the proposal even though the Defense Ministry was supportive. Gaining agreement on privileges and immunities to be granted U.S. servicemen engaging in military exercises has been just as tough sledding, as the Foreign Ministry saw it as "a foot in the door" and linked it with Brazil's strong opposition to Article 98 agreements. While we seek to get the GOB to move forward with an agreement governing space launches at the country's equatorial base at Alcantara, our pleas are met with silence even as Brazil has executed space-related agreements with Ukraine and others. On trade issues, when unscripted, President Lula has characterized the FTAA as "off his agenda." IPR is another sore point, as it has become clear that the USG and the Brazilian government have differing views on the protection to be afforded to intellectual property. Only after gargantuan efforts have we gotten the GOB to turn the corner on copyright piracy and (apparently) persuaded policymakers to seek negotiated solutions on compulsory licensing of AIDs anti-retrovirals.

15. (C) However, all our conversations are not difficult. At the personal level, Lula has met President Bush several times and the two have a good rapport. On issues involving matters perceived as technical in nature - i.e., law enforcement and science (but not the environment or counter-terrorism) - the GOB is eager to engage. For example, from 2003 to 2004, the GOB worked quietly with us on the timing and details of its shoot-down program to accommodate our statutory requirements (although now a new crop of GOB bureaucrats appears to be unaware of the government's past promises). Foreign Minister Amorim's statements to the press in the wake of his September 26 meeting with you, i.e., to the effect that Brazil would seek as a deliverable during the upcoming POTUS visit intensified bilateral dialogue on scientific, education, and environmental issues, reflect this desire to cooperate only

on matters of marginal interest to the U.S.

16. (C) On development assistance issues, our dialogue is positive - but still constrained. Despite lackluster results, the Brazilian government's multi-billion dollar poverty alleviation program - Zero Hunger - receives substantial funding from the World Bank and the IDB. Given USG budget constraints and the fact that Zero Hunger is, in essence, a cash transfer program, USAID support has been limited. Instead of focusing on cash transfers to the poor, USAID has sought to target its efforts towards promoting sustainable livelihoods - inter alia, through working with small and medium-sized enterprises. PA's Youth Ambassador program takes a similar targeted approach. This difference in focus, broad cash transfers versus targeted assistance, ends up putting the USG at the margins of Brazil's overall anti-poverty efforts.

#### FOREIGN POLICY

17. (C) In large part due to Brazil's ambivalence towards the United States, President Lula has run an activist foreign policy with a focus on South America and the Third World, seeking to forge alliances with other mid-sized powers (South Africa, India, etc). He has traveled extensively in pursuit of a higher international profile for Brazil. Despite prodding from the USG and others, Lula has refused to condemn Cuba for human rights violations and, in fact, has pushed for Cuban membership in the Rio Group. Brazil has also advocated a Cuba-Mercosul trade pact. In addition, the GOB has worked to increase both its economic and political ties with Venezuela. Enhanced integration of the two countries' energy sectors is high on its agenda. Lula has been especially solicitous of Chavez. During the September 29-30 South American Community of Nations Summit in Brasilia, Lula praised the Venezuelan President's democratic credentials ("if anything, Venezuela has an excess of democracy") and declared that the Chavez government had been demonized by its foes. We understand that the Lula administration even paid for the transportation costs of Brazil's youth contingent attending the recent Bolivarian Youth Festival in Venezuela. Given all this, it would be unrealistic to expect Brazilian activism in support of Venezuelan democracy.

18. (C) In the face of declining inter-bloc trade, Brazil has sought to revitalize Mercosul. It has pursued Mercosul-USG trade talks, an effort seen by many as a way to delay/derail the FTAA process. Indeed, given its size and natural resources, Brazil has long seen itself as the natural leader of the region (even though that perception is not shared by many of its neighbors).

19. (C) Emblematic of Brazil's efforts to gain greater standing on the world stage is its tenacious pursuit of a permanent UN Security Council (UNSC) seat. Brazil and other G4 states (India, Germany, Japan) are, despite recent setbacks, continuing to press their campaign for a vote on a resolution on UNSC reform. This stance is at odds with the position of many Latin American countries, including those which Brazil believes should follow its "natural leadership."

110. (C) Brazil has long seen international fora as a way to enhance its international stature. Reflecting this, in 2005 it launched failed national candidates for the top jobs at both the WTO and the IDB. The failure of both, together with the unlikely prospects for a permanent seat in the UNSC, has widely been seen in Brazil as a "political" disaster created by a badly designed foreign policy.

#### PRESIDENT LULA

111. (C) President Luiz Inacio Lula da Silva was inaugurated in January 2003 after a career as a Sao Paulo metalworker and labor leader. He founded the left-of-center Workers' Party (PT) in 1980 and lost three presidential campaigns before winning in the October 2002 elections. Lula is eligible to run for reelection in October 2006. Elected in large part on promises of promoting an ambitious social agenda, including a "Zero Hunger" program, Lula's government has failed to deliver much in this area, as managerial shortcomings and the need for fiscal restraint have limited progress. The public's top concern -- crime and public security -- have not improved under this administration

112. (C) In recent months the Lula Administration has been beset by a grave political crisis as interlocking influencing peddling/vote-buying scandals linked to important elements of Lula's PT party continue to unfold. The crisis has placed Lula on the defensive and caused near paralysis in the congress and the executive branch. Politics have become dominated by investigations, accusations and revelations. The President's Chief of Staff resigned his post, and he and several other congressmen are the subjects of investigations

and expulsion proceedings owing to bribery allegations. However, influential Finance Minister Palocci appears entrenched, despite recent corruption allegations against him -- which he has forcefully denied. Thus far Brazilian society -- including the opposition -- seems disinclined to hold Lula personally responsible for the scandals or press for impeachment proceedings. However, the breadth of the crisis and the continuing revelations have created a domestic political environment that is fluid and unpredictable. Indeed, some rumors link the President directly to the scandal. Lula's popularity has been badly damaged, with recent polls suggesting he could lose his re-election bid should he pursue it in 2006.

#### MACRO-ECONOMIC DEVELOPMENTS

13. (C) President Lula and his economic team have implemented prudent fiscal and monetary policies and pursued necessary microeconomic reforms. As a result, Brazil's economy, aided by a benign international environment, is having another solid year. GDP growth of 4.9% in 2004 has coupled with booming exports, healthy external accounts, inflation under control, decreasing unemployment and reductions in the debt-to-GDP ratio. In recent months, the real has risen sharply against the dollar and the Sao Paulo Stock Exchange (BOVESPA) has hit record levels. In March 2005, the Brazilian government declined to renew its Stand-by Agreement with the IMF and in mid-July it announced that it would pay early US\$5.12 billion in Standard Reserve Facility payments due by March 2006.

14. (C) Overall, while Brazil has made considerable progress, problems remain. Despite registering its first year-on-year decline in 2004, Brazil's (largely domestic) government debt remains high, at 52% of GDP. Real interest rates (at more than 13 percent) are among the highest in the world. Income and land distribution remain skewed. Investment (including FDI) is low. The country's sovereign risk ratings are, in general, three to four levels below investment grade. And the informal sector constitutes between 35 to 40 percent of the economy, in part because the tax burden (nearly 38 percent of GDP) is so high. The good news is that, so far, the uncertainty surrounding the political scandal has neither retarded economic growth or frightened away foreign investors.

15. (C) Sustaining high growth rates in the longer term depends on the impact of President Lula's structural reform program and efforts to build a more welcoming climate for investment, both domestic and foreign. In its first year, the Lula administration passed key tax and pension reforms to improve the government fiscal accounts. Judicial reform and an overhaul of the bankruptcy law, which should improve the functioning of credit markets, were passed in late 2004, along with tax measures to create incentives for long-term savings and investments.

16. (C) Public-Private-Partnerships, a key effort to attract private investment to infrastructure, also passed in 2004, although implementation of this initiative still awaits promulgation of the necessary regulations. Labor reform and autonomy for the Central Bank are on the agenda for 2005 but look increasingly unlikely to be addressed this year. Despite this well-considered reform agenda, much remains to be done to improve the regulatory climate for investment, particularly in the energy sector; to simplify tortuous tax systems at the state and federal levels; and to further reform the pension system. Given the current focus of Congress on the political scandal, prospects for much of this reform agenda are dim for the remainder of Lula's term.

#### TRADE POLICY

17. (C) To increase its international profile (both economically and politically), the Foreign Ministry (Itamaraty) is seeking expanded trade ties with developing countries, as well as a strengthening the Mercosul customs union with Uruguay, Paraguay and Argentina. In 2004, Mercosul concluded free trade agreements with Colombia, Ecuador, Venezuela and Peru, adding to its existing agreements with Chile and Bolivia to establish a commercial base for the newly-launched South American Community of Nations. This year Mercosul is pursuing free trade negotiations with Mexico and Canada and hopes to be able to resume trade negotiations with the EU. The trade bloc also plans to launch trilateral free trade negotiations with India and South Africa, building on partial trade liberalization agreements concluded with these countries in 2004. China has increased its importance as an export market for Brazilian soy, iron ore and steel, becoming Brazil's fourth largest trading partner and a potential source of investment. As many Brazilian observers have indicated, all this effort is aimed at countries which together represent less than a third of Brazil's foreign trade.

#### DOHA AGENDA - WTO

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118. (C) Brazil leads the G-20 group of developing countries that is pressing for agricultural trade reform in the WTO Doha Development Agenda negotiations. Brazil's assertive leadership of the G-20 was blamed in some quarters for causing the failure of the WTO Cancun Ministerial in September 2003. Since then, Brazil has been more constructively engaged in the Doha Round as a member of the "Five Interested Parties" informal group, although many of its positions are still at odds with U.S. interests. Brazil can be expected to maintain its assertive stance in the Doha Round on agricultural trade reform while taking more defensive postures in the discussions covering industrial products and services.

#### FREE TRADE OF THE AMERICAS - FTAA

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119. (C) As indicated above, the Lula Administration shows no serious interest in pursuing the FTAA. Despite serving as co-chair and having secured in the November 2003 Miami meeting a new framework for negotiation, Brazil has shown no inclination to move the process along and has failed to convoke the next FTAA Ministerial - which is now overdue.

CHICOLA